

Audit



Report

OFFICE OF THE INSPECTOR GENERAL

COMPILATION OF FY 1996 AIR FORCE CONSOLIDATED
FINANCIAL STATEMENTS AT THE DEFENSE FINANCE
AND ACCOUNTING SERVICE DENVER CENTER

Report No. 98-054

January 23, 1998

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Acronyms

AFAA	Air Force Audit Agency
CFO	Chief Financial Officers
DFAS	Defense Finance and Accounting Service
DJAS	Defense Joint Accounting System
GAO	General Accounting Office
IG	Inspector General
MAFR	Merged Accountability and Fund Reporting
OMB	Office of Management and Budget



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January 23, 1998

**MEMORANDUM FOR DIRECTOR, DEFENSE FINANCE AND ACCOUNTING
SERVICE**

**SUBJECT: Audit Report on Compilation of FY 1996 Air Force Consolidated Financial
Statements at the Defense Finance and Accounting Service Denver Center
(Report No. 98-054)**

We are providing this audit report for review and comments. The audit was performed in response to the Chief Financial Officers Act of 1990. Management comments on a draft of this report were considered in preparing the final report.

DoD Directive 7650.3 requires that all recommendations be resolved promptly. Comments from the Defense Finance and Accounting Service were partially responsive. We request that the Defense Finance and Accounting Service provide additional comments on Recommendation 1.a.(2) by March 24, 1998.

We appreciate the courtesies extended to the audit staff. For additional information on this report, please contact Mr. Richard B. Bird, Audit Program Director, at (703) 604-9175 (DSN 664-9175) or e-mail RBird@dodig.osd.mil, or Mr. W. Andy Cooley, Audit Project Manager, at (303) 676-7393 (DSN 926-7393) or e-mail ACooley@cleveland.dfas.mil. Enclosure D lists the distribution of this report. The audit team members are listed inside the back cover.

Robert J. Lieberman
Assistant Inspector General
for Auditing

Office of the Inspector General, DoD

Report No. 98-054
(Project No. 6FD-2026)

January 23, 1998

Compilation of FY 1996 Air Force Consolidated Financial Statements at the Defense Finance and Accounting Service Denver Center

Executive Summary

Introduction. The Chief Financial Officers Act of 1990, as amended by the Federal Financial Management Act of 1994, requires the Inspector General, DoD, to audit the DoD financial statements. We delegated the audit of the FY 1996 Air Force Consolidated Financial Statements to the Air Force Audit Agency. The Defense Finance and Accounting Service (DFAS) Denver Center maintained accounting records and prepared the FY 1996 financial statements for the Air Force. More than \$342 billion in total assets was reported at year's end in these statements, and total revenues for the year exceeded \$59 billion. The Air Force Audit Agency disclaimed an opinion on these statements. Our audit focused on the Chief Financial Officers Reporting System used by the DFAS Denver Center to compile the FY 1996 Air Force financial statements. The DFAS Denver Center developed the Chief Financial Officers Reporting System at a cost of \$586,750.

Audit Objectives. The primary audit objective was to determine whether the DFAS Denver Center consistently and accurately compiled financial data from field activities and other sources for the FY 1996 Air Force financial statements. We also determined whether FY 1996 ending balances reported by the DFAS Denver Center were supportable for use as beginning balances in the FY 1997 financial statements. In addition, we evaluated the DFAS Denver Center's compliance with applicable laws and regulations and its internal control program as related to our objectives.

Audit Results. Although significant financial management challenges remain, the DFAS Denver Center completed corrective actions on 16 of 28 prior recommendations made by the Inspector General, DoD, to improve the process of compiling the Air Force financial statements. See Appendix C, Other Matters of Interest, for details of the unresolved recommendations.

The DFAS Denver Center achieved a measure of success in using the Chief Financial Officers Reporting System to expedite the accurate and consistent preparation of the Air Force financial statements. However, the Chief Financial Officers Reporting System used the same data sources as the manual process it replaced. Therefore, material weaknesses identified in prior audits still limited the reliability of the Air Force financial statements for FY 1996. Additionally, the ending balances reported in

those financial statements cannot be relied on as beginning balances for the next fiscal year. The Chief Financial Officers Reporting System was not adequately documented or controlled, and the DFAS Denver Center had not adequately planned for required programming support. Inadequate system documentation and control may adversely affect the future operation of the Chief Financial Officers Reporting System, and significant costs will be incurred to develop or contract for programming support required for system maintenance. See Appendix A for details of the internal control program.

Summary of Recommendations. We recommend that the Director, DFAS Denver Center, improve the documentation and security for the Chief Financial Officers Reporting System and approve future plans to maintain the system.

Management Comments and Audit Response. We issued a draft of this report on August 29, 1997, and received comments from DFAS. Management concurred with all recommendations. Management agreed to improve the documentation and security for the Chief Financial Officers Reporting System and approve future plans to maintain the system. Management designated a systems administrator to annually review and report on access controls over the Chief Financial Officers Reporting System. Except in one instance, management comments were fully responsive. Having a systems administrator review access controls annually is not adequate. System access should be monitored and reviewed periodically throughout the year. We request that DFAS provide additional comments by March 24, 1998. The DFAS Denver Center's comments were considered in preparing the final report. See Part I for a discussion of the management comments and Part III for the complete text of the comments.

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Part I - Audit Results

Audit Background

Audit Requirement. Public Law 101-576, the Chief Financial Officers Act of 1990 (the CFO Act), as amended by the Federal Financial Management Act of 1994, requires the Inspector General (IG), DoD, or an independent auditor appointed by the IG, DoD, to audit the financial statements of DoD reporting entities. We delegated the audit of the FY 1996 Air Force Consolidated Financial Statements to the Air Force Audit Agency (AFAA). The Defense Finance and Accounting Service (DFAS) Denver Center maintains records for the Department of the Air Force and prepared the FY 1996 Air Force financial statements from data submitted by the Air Force and other DoD organizations. More than \$342 billion in total assets was reported at year's end in these statements and total revenues for the year exceeded \$59 billion. AFAA disclaimed an opinion on the FY 1996 statements. We reviewed the compilation of the financial statements at the DFAS Denver Center. Our audit focused on the Chief Financial Officers Reporting System (the CFO Reporting System) used by the DFAS Denver Center to compile the FY 1996 Air Force financial statements.

CFO Reporting System. In 1995, the DFAS Denver Center established the CFO Act Compliance Program Project, under which the CFO Reporting System was developed. The project was established to find a better method of meeting the financial reporting requirements of the DFAS Denver Center. Before the CFO Reporting System was used, the DFAS Denver Center relied on a manual process to prepare the Air Force financial statements. Budgetary and financial data were manually extracted from a variety of sources and were then manually summarized in a spreadsheet. The spreadsheet was used to consolidate the data and provide the financial information necessary to manually produce the general ledger, trial balance, and financial statements. DFAS Denver Center had not documented the procedures for compiling and inputting data to the spreadsheet and the rationale for the automated spreadsheet calculations. Thus, the financial statements were subject to a higher risk of material misstatements because of the increased potential for procedural inconsistencies and human error. Among other objectives, the CFO Reporting System was developed to document and expedite (through automation) the process used by the DFAS Denver Center to prepare the Air Force financial statements. The DFAS Denver Center developed the CFO Reporting System at a cost of \$586,750.

Supporting Computer Systems. The CFO Reporting System relied primarily on data from external sources and the following internal computer systems.

- o The Status of Funds database, which is part of the Departmental On-Line Accounting and Reporting System, contains budget information

summarized by appropriation. The CFO Reporting System automatically extracts data only from the Status of Funds database. Payment and collection transactions from the Merged Accountability and Fund Reporting (MAFR) system are systematically included in the Status of Funds database at the appropriation level.

- o The Air Force General Funds General Ledger, which provides some accounting information, is summarized by Air Force base and general ledger account code.

The DFAS Denver Center has little control over some of the data, and the reliability of much of the data cannot be confirmed at the Air Force level. For this and other reasons, the AFAA has disclaimed an opinion on the Air Force Consolidated Financial Statements for FYs 1992 through 1996.

Audit Objectives

The primary audit objective was to determine whether the DFAS Denver Center consistently and accurately compiled financial data from field activities and other sources for the FY 1996 Air Force Consolidated Financial Statements. We also determined whether the FY 1996 ending balances reported by the DFAS Denver Center were supportable for use as beginning balances in the FY 1997 financial statements. In addition, we evaluated the DFAS Denver Center's compliance with applicable laws and regulations and its internal control program, as it related to our objectives. See Appendix A for a discussion of the scope and methodology and the results of our review of the internal control program. See Appendix B for prior audits and other reviews and Appendix C for a discussion of unresolved issues from prior audits.

Chief Financial Officers Reporting System

The DFAS Denver Center achieved a measure of success in expediting the accurate and consistent preparation of the Air Force financial statements utilizing the CFO Reporting System. However, the CFO Reporting System used the same data sources as the manual process it replaced. Therefore, material weaknesses identified in prior audits still limit the reliability of the Air Force financial statements. As a result, users of the financial statements could not rely on the FY 1996 Air Force financial statements. Additionally, the ending balances reported in those financial statements cannot be relied on as beginning balances for the next fiscal year.

The DFAS Denver Center did not adequately document the CFO Reporting System and did not adequately plan for system security and programming support required to maintain the system. Specifically,

- o the design and operation of the CFO Reporting System were not adequately documented during system development,
- o access to the CFO Reporting System and to a critical system component was not adequately controlled, and
- o the system cannot be maintained without unique programming support or extensive reprogramming.

The CFO Reporting System was not adequately documented because management believed that on-line help screens would be sufficient. Additionally, a key manual operating procedure was not documented because management did not consider the need to ensure the consistent application of the procedure in the future. Finally, provisions for adequately maintaining and providing security for the system were not made because the time and materials contract did not specifically require them. Although these inadequacies did not distort the data on the FY 1996 Air Force financial statements, correction will ensure the consistent application of system procedures, provide the necessary system software and processing integrity, and provide for the future operation of the CFO Reporting System.

Prior Audit Issues

Key Financial Accounting System Issues. As detailed in Appendixes B and C, financial statements prepared using the CFO Reporting System are still subject to the same material management control weaknesses reported in prior audits by the General Accounting Office (GAO); the IG, DoD; and the AFAA. One of the key financial accounting system issues identified in these prior audits is the absence of a transaction-driven general ledger system for producing the Air Force financial statements.

Issues Identified by GAO. The GAO first identified this problem in a 1990 report on the FY 1988 Air Force financial statements. In a 1992 followup audit, GAO reported that the Air Force accounting and financial management systems were still not integrated under a transaction-driven general ledger. GAO stated that consequently, much of the information generated by the systems was inaccurate and unreliable.

Issues Identified by IG, DoD. In this audit and in prior reports, the IG, DoD, also noted that the financial information reported in the Air Force financial statements for FYs 1992 through 1996 was not derived from a transaction-driven general ledger system. Instead, the financial statements were prepared using budgetary and other data from the Status of Funds system and other sources. Therefore, the Air Force financial statements were not reliable.

Issues Identified by AFAA. The AFAA disclaimed an opinion on the Air Force financial statements for FYs 1992 through 1996. One of the key reasons cited by AFAA for its disclaimers was that the financial data used to develop the Air Force financial statements were not produced by a transaction-driven general ledger, and existing accounting systems could not produce auditable financial statements.

Other problems exist with inadequate automated information systems, reconciliation and resolution of U.S. Treasury clearing accounts, and internal controls over the MAFR system (see Appendixes B and C). As discussed below, the CFO Reporting System was not intended to provide transaction-driven general ledger controls or resolve other problems affecting the auditability and reliability of the Air Force financial statements.

CFO Reporting System Issues. The CFO Reporting System was primarily developed to document and expedite (through automation) the undocumented

*DFAS is developing the Defense Joint Accounting System (DJAS) as the migratory system for future financial operations at the DFAS Denver Center. However, DJAS will not be operational until December 1999.

Chief Financial Officers Reporting System

manual procedures used by the DFAS Denver Center in preparing the Air Force financial statements. It serves as a report writer that compiles budgetary and financial data from existing sources, regardless of any problems previously identified in these sources by prior audits. Data are input to the CFO Reporting System from automated and manual sources.

- o The CFO Reporting System automatically extracts budgetary data from the Air Force Status of Funds system. The extract is reconciled directly to the DD Form 1176, "Report on Budget Execution," (the DD Form 1176 report) produced by the Status of Funds system. Submitted monthly to the U.S. Treasury, the DD Form 1176 report summarizes the status of budgetary resources and related financial data.

- o Most dollar values used by the CFO Reporting System to prepare the Air Force financial statements are still derived from manual inputs of journal vouchers made by accounting personnel to adjust the beginning account balances. In absolute values, automated inputs represented only \$187 billion of the \$687 billion in combined amounts reported for assets, liabilities, and net position in the Air Force Statement of Financial Position as of September 30, 1996.

The automated extract made by the CFO Reporting System converts the balance identifiers used in budgetary reporting to a general ledger account, based on posting rules and tables established in a critical spreadsheet integrated into the system. Data inputs are assigned to general ledger accounts in summary values at the Department of the Air Force level, not at the individual transaction level.

Conclusion. The CFO Reporting System did not substantially improve the process of preparing the Air Force financial statements. Rather, it automated some manual processes, with little improvement in the quality of data reported. As discussed below, the system achieved only limited success in automating and documenting the process used to prepare the Air Force financial statements. Problems were also identified in system security.

System Documentation

GAO Documentation Requirement. The design and operation of the CFO Reporting System was not adequately documented. Title 2 of the GAO "Policy and Procedures Manual for Guidance of Federal Agencies," August 1987, Appendix III, Chapter 5, states:

An agency's accounting system, including both manual and automated components, must be documented. The documentation must cover

Chief Financial Officers Reporting System

(1) the system's development, describing the baseline of the system and the analysis and development actions undertaken, and (2) the system's actual operation, describing the financial management and accounting aspects, how the functional users and operators interact with and use the system, and the computer program narratives and listings.

The documentation must be complete, current, and maintainable. In addition, it must be of sufficient scope and depth to provide management, users, systems operation and maintenance personnel, and auditors and other evaluators with an understanding of the design and operation of each component in the system and its integration with and relation to all other components. Documentation of the operational accounting system must be appropriately safeguarded and must be periodically updated so that it reflects actual operations.

Prior Issues. The DFAS Denver Center has experienced problems with undocumented procedures used in preparing the Air Force financial statements. Correcting these documentation problems was one of the key reasons the DFAS Denver Center established the CFO Act Compliance Program Project in 1995. The CFO Reporting System was developed under this project. Prior to the CFO Reporting System, the DFAS Denver Center manually summarized data extracted from a variety of sources in a spreadsheet. That spreadsheet was used to consolidate the data and provide the financial information necessary to produce the general ledger, trial balance, and financial statements. However, the rationale for the spreadsheet inputs and calculations was not documented. Required knowledge for preparing the Air Force financial statements was being lost because of staff turnover. Thus, the financial statements were subject to a higher risk of material misstatements because of the increased potential for procedural inconsistencies and human error. The CFO Reporting System was developed to provide an automated and documented system for preparing the Air Force financial statements.

System Documentation. The DFAS Denver Center did not adequately document the design and operation of the CFO Reporting System. DFAS Denver Center personnel intended to meet these requirements by including on-line help screens in the system's design. However, these help screens provide only an overview of each major system function, not the thorough understanding of the system that is required to answer user questions or resolve problems. Because of inadequate system documentation, the contractor developing the CFO Reporting System had to rehire one of the original programmers to make system changes required to produce the FY 1996 Air Force financial statements. Another example of the documentation problems is the lack of documentation for reconciling data inputs to the CFO Reporting System.

Chief Financial Officers Reporting System

Reconciliations of Imported Data. One of the key controls included in designing the CFO Reporting System was an automated reconciliation of the budgetary data imported by the system from the Status of Funds system. The CFO Reporting System imported budgetary data with an absolute value of \$187 billion from the Status of Funds system for use in preparing the FY 1996 Air Force financial statements. When the DFAS Denver Center determined that the automated reconciliation had not worked properly, a manual reconciliation was made in preparing the FY 1996 Air Force financial statements. The CFO Reporting System automatically imports budgetary data from the Status of Funds system, converting the balance identifiers used in budgetary reports to general ledger accounts. An automated reconciliation was designed to verify that the data imported into the CFO Reporting System equaled control figures on the DD Form 1176 reports produced by the Status of Funds system. The automated reconciliation could not be performed because the DD Form 1176 report contained extraneous data related to canceled accounts that were reestablished by the U.S. Treasury for processing accounting corrections. The programming for the automated reconciliation did not make proper adjustments for this extraneous data.

The basis for making the manual reconciliation was not documented. Personnel in the CFO Branch, DFAS Denver Center Directorate of Departmental Accounting, manually reconciled and verified the accuracy of data imported from the Status of Funds system. Because the rationale and procedures for making the manual reconciliation were not documented, future reconciliations may be performed inconsistently or not at all. As a result, financial data from different reporting periods may not be comparable, thus seriously degrading the ability of users to analyze financial data from more than one reporting period.

Conclusion. The lack of documentation for the design and operation of the CFO Reporting System perpetuates the high risk of material misstatements in the Air Force financial statements because of the increased potential for procedural inconsistencies and human error.

System Security

OMB Security Requirement. User access to the CFO Reporting System and a critical spreadsheet used by the system were not adequately controlled. Office of Management and Budget (OMB) Circular No. A-130, "Management of Federal Information Resources," February 8, 1996, Appendix III, requires agencies to implement and maintain a program to assure that adequate security is provided for all information collected, processed, transmitted, stored, or disseminated in general support systems and major applications. DFAS

Chief Financial Officers Reporting System

5200.28-R, "DFAS Automated Information Systems Security Policy," September 1993, requires that passwords be changed annually and be at least six alphanumeric characters in length. The CFO Reporting System did not meet these OMB and DFAS requirements in establishing system passwords or protecting a critical spreadsheet.

System Passwords. Contrary to DFAS 5200.28-R, the DFAS Denver Center did not design the CFO Reporting System to automatically require passwords at least six alphanumeric characters in length or enforce requirements for annual changes to the passwords. Furthermore, to gain quicker access to the system, authorized users could delete their passwords altogether and still obtain access to the CFO Reporting System. When users deleted their passwords, other authorized users could access the CFO Reporting System under the first user's identity and access capability. When a user signs on to the CFO Reporting System, a list of authorized users appears. Authorized users highlight their own names, enter their passwords, and are given access to the system. If a user deletes his or her password, other authorized users can access the system by highlighting the first user's name. As discussed below, deleting these system passwords also increased the risk that unauthorized individuals might gain access to the CFO Reporting System under another user's identity by using the unprotected computers of authorized users.

A compensating control would not have substituted for system passwords, but could have reduced the risk of unauthorized access to the computers assigned to authorized users. Access to the CFO Reporting System is available to authorized users through Microsoft Windows on the DFAS Enterprise Local Area Network. Microsoft Windows allows users to establish screen saver passwords that are automatically activated whenever the computer is idle for a specified time interval. To be an effective control when someone is temporarily absent from their work stations, the time interval should be relatively short. When combined with the access controls on the DFAS Enterprise Local Area Network, this screen saver password helps reduce the risk that unauthorized individuals may gain access to the CFO Reporting System when authorized users are temporarily absent from their workstations.

Out of 16 authorized users, 10 were reviewed, and only 1 had established a screen saver password. However, the 10-minute time interval set by this user was too long to be an effective control. Because of the inadequate password controls, the CFO Reporting System was exposed to unauthorized change. During the audit, but before the statements were prepared, authorized users with previously deleted system passwords had reestablished and maintained their passwords. However, passwords used by 5 of 16 authorized users did not meet the minimum length requirements of DFAS 5200.28-R. Our review did not disclose any distortion of financial data caused by unauthorized access to the CFO Reporting System.

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Excel Spreadsheet. The design of the CFO Reporting System incorporates an Excel spreadsheet that is critical to the system's operation. That spreadsheet contains about 12,000 rules and tables used in importing data from the Status of Funds system to the CFO Reporting System. Among other uses, these rules and tables establish the basis for converting the balance identifiers used in budgetary reporting to general ledger accounts, and specify mathematical formulas for allocating costs only during the importing of data from the Status of Funds system database. By signing on to the CFO Reporting System, any authorized user had full access to the spreadsheet. Thus, authorized users could deliberately or accidentally add, edit, or delete any or all of the rules and tables used by the spreadsheet. DFAS Denver Center personnel stated that such access was granted to allow contracting personnel to make changes and enhancements during system development. However, allowing such unrestricted access to all authorized users made it possible for them to corrupt or change the spreadsheet without detection. A material corruption of the spreadsheet could cause significant harm to the spreadsheet if undetected before making periodic system backups. The data reconciliation previously discussed, when adequately performed, will detect any distortion of data caused by corruption of the spreadsheet. However, a material corruption of the spreadsheet would delay processing and cause the DFAS Denver Center to spend extra funds to restore the spreadsheet.

Conclusion. Inadequate security over the CFO Reporting System jeopardizes the integrity of system software and processing. Although data on the FY 1996 Air Force financial statements were not distorted, future statements produced by the CFO Reporting System may not be reliable because of the lack of system integrity. Any corruption of the Excel spreadsheet would be detected by the data reconciliation.

System Maintainability

System Development. The DFAS Denver Center did not adequately plan for the programming support required to maintain the CFO Reporting System. On May 8, 1997, after the DFAS Denver Center had incurred costs of \$586,750, the contract for developing the CFO Reporting System expired with no contract or other means in place for providing the required programming support. The CFO Reporting System cannot be maintained without unique programming support or extensive reprogramming. In contracting for system development, DFAS Denver Center management approved the use of a commercial software product, Visual FoxPro 3.0. DFAS Denver Center management made that decision knowing it would preclude routine software support from the DFAS Financial System Activity Denver, Financial Services Organization. DFAS software standards established later did not include Visual FoxPro 3.0;

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therefore, internal programming support is still not available within DFAS. Therefore, to maintain the CFO Reporting System, the DFAS Denver Center will incur additional costs to develop internally or contract for nonstandard programming support, or to reprogram the system in one of the DFAS software standards. When the development contract expired, the DFAS Denver Center had no estimate of the additional programming costs required to maintain the CFO Reporting System.

FY 1996 Financial Statements. In preparing the FY 1996 Air Force financial statements, the contractor employee who originally programmed the CFO Reporting System was rehired to correct deficiencies and develop programs to allow the system to function properly. Accounting personnel at the DFAS Denver Center and contractor programmers had unsuccessfully tried to operate the CFO Reporting System on their own. However, the lack of adequate system documentation severely hampered the contractor programmers in their efforts to make programming changes. The original programmer was rehired because the delays encountered had jeopardized the timely production of the Air Force financial statements.

Future Financial Statements. Financial reporting requirements for FY 1997 are comparable to the FY 1996 reporting requirements. However, beginning October 1, 1997, significant changes will be required in the format and content of FY 1998 financial statements submitted for the Air Force and other Federal reporting entities. These changes are dictated by financial accounting standards issued by the Financial Accounting Standards Advisory Board. To meet these new reporting requirements, the DFAS Denver Center will need to significantly reprogram the CFO Reporting System. In planning such system changes, DFAS Denver Center managers will also need to weigh the costs and benefits of converting the system programming to the DFAS standard software.

Conclusion. As noted in discussing the Scope and Methodology in Appendix A, this audit did not evaluate the procedures followed by the DFAS Denver Center in contracting for the development of the CFO Reporting System. These contracting procedures were being evaluated in a Defense Hotline audit. However, the lapse in programming support for the CFO Reporting System indicates that during system development, DFAS Denver Center managers did not adequately plan for continued system maintenance. The absence of required programming support jeopardized the future operation of the CFO Reporting System. Although corrective actions are now in process, the Director, DFAS Denver Center, should oversee plans for maintaining the CFO Reporting System.

Summary

The CFO Reporting System achieved a measure of success in expediting the accurate and consistent application of procedures (though undocumented) used by the DFAS Denver Center in preparing the Air Force financial statements. However, the gains achieved are diminished by material weaknesses in system documentation, security, and maintainability. Also, the financial statements produced by the CFO Reporting System continue to be unreliable because of problems with the computer systems as identified in prior audits, and problems with data used by the CFO Reporting System. The CFO Reporting System will be replaced by the Defense Joint Accounting System (DJAS), currently under development by DFAS. For these reasons, we question the value of any extensive development efforts to correct the problems identified by this audit in the CFO Reporting System. Therefore, we are making limited recommendations to correct these problems.

Recommendations, Management Comments, and Audit Response

1. We recommend that the Director, Directorate of Departmental Accounting, Defense Finance and Accounting Service Denver Center:

a. Direct the Chief, Chief Financial Officers Branch, Directorate of Departmental Accounting, to:

(1) Document the procedures used to manually reconcile the data imported into the Chief Financial Officers Reporting System from the DD Form 1176, "Report on Budget Execution," produced by the Status of Funds system.

Management Comments. DFAS concurred, stating that the process was documented in a Branch Operating Instruction issued in June 1997.

(2) Periodically monitor access controls over the Chief Financial Officers Reporting System and provide annual written reports on compliance with Recommendations 1.b.(1) and (2) below.

Management Comments. DFAS concurred, stating that a system administrator has been designated to review and control access to the CFO Reporting System and produce an annual report for management's use. The DFAS stated that all actions would be completed by June 1998.

Chief Financial Officers Reporting System

Audit Response. Although DFAS concurred, we do not consider its comments responsive. Because the CFO Reporting System is used for various purposes throughout the year, system access should be monitored periodically throughout the year, not annually as proposed by management. Requiring annual written reports on these periodic reviews should allow management to evaluate the adequacy of the reviews. We request that DFAS reconsider its position on Recommendation 1.a.(2) and provide additional comments in response to the final report.

b. Direct all authorized users of the Chief Financial Officers Reporting System to establish:

(1) Passwords of at least six alphanumeric characters for obtaining access to the Chief Financial Officers Reporting System.

(2) Screen saver password controls in Microsoft Windows.

Management Comments. DFAS concurred, stating that all users of the CFO Reporting System now have screen savers with password controls and are required to establish passwords of at least six alphanumeric characters. Corrective actions were completed in December 1996.

2. We recommend that the Director, Defense Finance and Accounting Service Denver Center, review and approve future plans for maintaining the Chief Financial Officers Reporting System.

Management Comments. DFAS concurred, stating that the Director, DFAS Denver Center, will review and approve all future plans for maintaining the CFO Reporting System. Corrective action was completed in October 1997.

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Part II - Additional Information

Appendix A. Audit Process

Scope and Methodology

We reviewed the process used by the DFAS Denver Center to compile financial data from Air Force field activities and other sources for inclusion in the FY 1996 Air Force Consolidated Financial Statements. Our audit focused on the CFO Reporting System used by the DFAS Denver Center to compile the FY 1996 Air Force financial statements. To assess compliance with OMB guidance, GAO standards, and DoD accounting policies, we reviewed systems and operational documentation supporting the processing of financial transactions within the CFO Reporting System. Those documents included contract deliverables and on-line documentation within the system. We also reviewed passwords used to control access to the CFO Reporting System. In addition, we identified recommendations from prior IG, DoD, audits at the DFAS Denver Center that affected the compilation of data for the FY 1996 financial statements.

Limitations to Scope. The scope of this audit was limited in the following respects.

Auditor Opinion. The objective of our audit was to evaluate whether the DFAS Denver Center fulfilled its responsibilities for preparing the Air Force financial statements. Accordingly, we did not render an opinion of the financial statements. AFAA issued a disclaimer of opinion on the Air Force financial statements in its Report No. 96053001, "Opinion on Fiscal Year 1996 Air Force Consolidated Financial Statements," March 1, 1997. We did not evaluate the accuracy of data provided by Air Force field activities. The AFAA included this evaluation in its review.

Other Financial Statements. We did not evaluate the CFO Reporting System's compilation procedures used by the DFAS Denver Center to prepare the Air Force Defense Business Operations Fund Consolidated Financial Statements for FY 1996. However, the system documentation, security, and maintainability problems discussed in Part I affect other financial statements prepared using the CFO Reporting System.

System Development. The scope of this audit did not include evaluating the procedures followed by the DFAS Denver Center in contracting for the development of the CFO Reporting System. Those and other DFAS

contracting functions are being evaluated under ongoing IG, DoD, Project No. 7CK-8009, "Audit of DoD Hotline Allegation on Contracting for Defense Finance and Accounting Service Support."

Use of Computer-Processed Data. To achieve the audit objectives, we relied extensively on computer-processed data in the CFO Reporting System. Our review of system controls raised questions about data validity. The DFAS Denver Center has initiated corrective actions by contracting for the DJAS, which is scheduled to use a transaction-driven general ledger system. DFAS Denver Center management expects the DJAS to be completed in December 1999.

Audit Period, Standards, and Locations. We performed this financial-related audit from May 1996 through April 1997 in accordance with auditing standards issued by the Comptroller General of the United States, as implemented by the IG, DoD. We included tests of management controls considered necessary.

Contacts During the Audit. We visited or contacted individuals and organizations within the DoD. Further details are available on request.

Management Control Program Review

DoD Directive 5010.38, "Internal Management Control Program," April 14, 1987,* requires DoD organizations to implement a comprehensive system of management controls that provides reasonable assurance that programs are operating as intended and to evaluate the adequacy of the controls.

Scope of Review of Management Control Program. We reviewed the adequacy of the management controls over the preparation of financial statements and the DFAS Denver Center's self-evaluation of those controls. Specifically, we reviewed the management controls over the CFO Reporting System to determine whether the system was complete and auditable and whether adequate documentation existed to ensure data integrity.

Adequacy of Management Controls. We identified material management control weaknesses at DFAS, as defined by DoD Directive 5010.38. Documentation, security, and maintainability for the CFO Reporting System were not adequate to ensure the consistent application of system procedures,

*DoD Directive 5010.38 has been revised as "Management Control Program," August 26, 1996. The audit was performed under the April 1987 version of the directive.

Appendix A. Audit Process

provide the necessary integrity for the system software and processing, and provide for the future operation of the system. The weaknesses did not affect the compilation of the FY 1996 Air Force financial statements, but may affect future statements. Implementing Recommendations 1.a.(1), 1.a.(2), 1.b.(1), and 1.b.(2) will improve management controls over system documentation and security, but will not correct the material weaknesses identified in prior audits. For the reasons given in the summary of our finding, we made only limited recommendations to correct the weaknesses identified by the audit. Implementing Recommendation 2., for increased management oversight of future plans to maintain the CFO Reporting System, should ensure adequate planning. A copy of the report will be provided to the senior DFAS official responsible for management controls.

Adequacy of Management's Self-Evaluation. DFAS Denver Center officials identified the operations in the CFO Reporting System as a part of the Status of Appropriations assessable unit. However, the officials had not performed a risk assessment since the implementation of the CFO Reporting System; therefore, the risk assessment was based on outdated systems information. DFAS Denver Center officials plan to perform a risk assessment by FY 1998. Because officials responsible for the Status of Appropriations assessable unit had not performed an assessment recently, they did not identify or report the material management control weaknesses identified by the audit.

Appendix B. Summary of Prior Coverage

The GAO; the IG, DoD; and the AFMAA have issued numerous reports that identified weaknesses in the internal controls over the compilation of data used in the Air Force financial statements. Although not previously audited, the new CFO Reporting System is affected by the issues reported in these prior audits, discussed below and in Appendix C.

General Accounting Office

Report No. AFMD-92-12 (OSD Case No. 8376-L), "Aggressive Actions Needed for Air Force to Meet Objectives of the CFO Act," February 19, 1992. This report discussed the progress made by DoD and the Air Force in implementing the recommendations made by GAO in its audit of the FY 1988 Air Force financial statements. The principal findings were that financial systems were not integrated and generated unreliable information, the reported costs of weapon systems were unreliable, accounting and controls over Air Logistics Command inventories were inadequate, internal accounting controls were not adequate, and short-term actions were needed to improve the quality of financial data and to ensure the completion of a financial statement audit. GAO reaffirmed all 26 recommendations included in its prior report (discussed below) and made additional recommendations to improve management's accountability, internal controls, and the quality of financial information, and to assist the Air Force in meeting the objectives of the CFO Act. The DoD Comptroller (now the Under Secretary of Defense [Comptroller]) generally concurred with all recommendations made in this report.

Report No. AFMD-90-23 (OSD Case No. 8193-A), "Air Force Does Not Effectively Account for Billions of Dollars of Resources," February 23, 1990. This audit focused on the GAO review of the accounts contained in the FY 1988 Air Force financial statements. The principal findings were that financial systems did not provide reliable financial data, basic internal control weaknesses existed, the full costs of weapon systems were not identified, and inventory systems did not provide accurate data. The DoD Comptroller (now the Under Secretary of Defense [Comptroller]) concurred with all 26 recommendations in the report. Recommendations were made to use existing financial information and develop more accurate financial information, perform reconciliations and document adjustments, account for the costs of weapon systems, achieve financial management of inventories, and develop a new accounting system.

Inspector General, DoD

Report No. 97-057, "Compilation of FY 1995 Air Force Consolidated Financial Statements at the Defense Finance and Accounting Service Denver Center," December 27, 1996. This report stated that the DFAS Denver Center did not provide sufficient evidence that it had accurately compiled financial data from field organizations and other sources for the FY 1995 Air Force Consolidated Financial Statements. The report had two findings.

- o The DFAS Denver Center did not report negative accounts payable of \$882.3 million and did not disclose the use of unreliable data in preparing the financial statements. As a result, we could not confirm the reliability of \$4 billion in accounts payable to non-Federal entities, as reported in the financial statements. In addition, users of the financial statements were not aware that they could not rely on the accuracy of reported accounts payable transactions.

- o The Command On-Line Accounting and Reporting System, a major source of data for financial reports, did not provide adequate audit trails for verifying adjustments made by the DFAS Denver Center. Therefore, DFAS Denver Center managers did not have reasonable assurance that all adjustments were adequately supported, classified, coded, and recorded.

Management concurred with the recommendations made in this report. Recommendations were made to establish milestones for and monitor the progress of changes in the automated information system for reporting accounts payable; to provide accounting personnel with guidance on financial statement disclosures; and to establish a complete and accurate audit trail of all adjustments made by DFAS Denver Center personnel in the Command On-Line Accounting and Reporting System until the development of DJAS is completed.

Report No. 95-301, "Major Deficiencies Preventing Auditors From Rendering Audit Opinions on DoD General Fund Financial Statements," August 29, 1995. This report summarized the major deficiencies impeding the ability of DoD to produce auditable financial statements. Four major deficiencies prevented auditors from rendering opinions on Army and Air Force General Fund financial statements.

- o Accounting systems supporting DoD General Funds did not have an integrated, double-entry, transaction-driven general ledger to compile and report reliable and auditable information.

- o Material deficiencies existed in reporting \$612.9 billion of assets on the FY 1994 Statements of Financial Position.

Appendix B. Summary of Prior Coverage

- o Auditors could not determine the reasonableness and accuracy of various accounts because the amounts were derived from unreliable disbursement and collection data.

- o Auditors could not determine the reasonableness of the amounts or disclosures made related to contingent liabilities that should have been recognized as liabilities on the FYs 1993 and 1994 Statements of Financial Position.

The report also summarized the actions taken or under way to correct these deficiencies. The report contained no recommendations. Management did not disagree with any facts or conclusions in the report.

Report No. 95-264, "Defense Finance and Accounting Service Work on the Air Force FY 1994 Financial Statements," June 29, 1995. This report identified material weaknesses in the security oversight provided by the DFAS Denver Center to the MAFR system and in the system's audit trail for entries made at the DFAS Denver Center. The report contained no recommendations because management had already initiated corrective actions to improve security and establish required audit trails in the Defense Cash Management System, which will replace the MAFR system.

Report No. 95-067, "Defense Finance and Accounting Service Work on the Air Force FY 1993 Financial Statements," December 30, 1994. This report identified a material weakness in the DFAS Denver Center's oversight of U.S. Treasury clearing account balances and material errors in amounts reported in the Air Force financial statements for accounts receivable and accounts payable. Management concurred with all recommendations made in this report. Recommendations established policies and procedures to monitor U.S. Treasury clearing accounts and to improve the process used to compile and report amounts in the financial statements.

Report No. 94-073, "Defense Finance and Accounting Service Work on the Air Force FY 1992 Financial Statements," March 31, 1994. This report stated that the DFAS Denver Center did not prepare complete, accurate, and reliable FY 1992 financial statements for the Air Force. The report had four findings.

- o DFAS Denver Center did not comply with DoD accounting requirements or maintain effective procedures or controls for the accounting systems used in preparing the financial statements. Causes cited for those conditions included the lack of a transaction-driven general ledger, failure to verify and reconcile MAFR system outputs to field-level data, and premature cutoff dates for military pay. As a result, the financial statements were unreliable.

Appendix B. Summary of Prior Coverage

- o Internal controls over budgetary data that the DFAS Denver Center used to prepare the financial statements were not effective. The internal control weaknesses existed because DFAS Denver Center did not use the DoD uniform chart of accounts, did not confirm transactions with field organizations, relied on a budgetary system instead of the general ledger system, and forced records to agree with U.S. Treasury balances.

- o Revenues on the Statement of Operations were overstated and operating expenses were misstated because personnel did not properly classify and record revenues, expenses and losses.

- o The DFAS Denver Center did not validate the accuracy of construction-in-progress data or comply with Air Force guidance on Government-furnished material and contractor-acquired material. Those conditions occurred because no procedures existed for verifying the validity, propriety, or accuracy of the amounts that DoD Components reported as construction-in-progress. Also, the DFAS Denver Center's internal guidance was inconsistent with DoD and Air Force regulations on reporting Government-furnished material and contractor-acquired material.

Recommendations were made to establish accounting systems, issue additional regulatory guidance, ensure compliance with existing regulations, enhance internal controls, and implement formal internal control procedures. DFAS nonconcurred with some of the findings and recommendations concerning the use of the general ledger system, stating that the accounting data provided by the budgetary system was more accurate than the data provided by the Air Force general ledger system. Correction will occur with the development and implementation of DJAS.

Air Force Audit Agency

The AFAA issued five reports in which it disclaimed an opinion on the Air Force Consolidated Financial Statements for FYs 1992 through 1996. AFAA disclaimed an opinion because they could not obtain sufficient evidence or apply other auditing procedures required to determine the fairness of the information presented in the financial statements. In support of its opinion reports, the AFAA issued 11 other reports on FY 1996 Air Force Consolidated Financial Statements, 9 reports related to FY 1995, 5 reports related to FY 1994, 11 reports related to FY 1993, and 20 reports related to FY 1992. Details on the other reports are provided in the AFAA opinion reports, which are summarized below.

Appendix B. Summary of Prior Coverage

- o Project No. 96053001, "Opinion on Fiscal Year 1996 Air Force Consolidated Financial Statements," March 1, 1997.
- o Project No. 95053001, "Opinion on Fiscal Year 1995 Air Force Consolidated Financial Statements," March 1, 1996.
- o Project No. 945053001, "Opinion on Fiscal Year 1994 Air Force Consolidated Financial Statements," March 1, 1995.
- o Project No. 94053022, "Opinion on Fiscal Year 1993 Air Force Consolidated Financial Statements," June 30, 1994.
- o Project No. 92053011, "Review of FY 1992 Air Force Consolidated Financial Statements," June 29, 1993.

In its disclaimer on the FY 1996 financial statements, the AFAA stated that its primary reason for not rendering an opinion was that financial information used to compile the FY 1996 Air Force Consolidated Financial Statements was not reliable, and financial systems and processes and the associated internal control structure were not adequate to produce reliable financial information. The AFAA also determined that several of the conditions causing it to disclaim an opinion for FYs 1992 through 1995 still existed. No recommendations were made in the AFAA opinion report because they were included in other reports.

Appendix C. Other Matters of Interest

Previously Reported Issues

Of the 22 IG, DoD, audit recommendations open on or issued after October 1, 1995, the DFAS Denver Center completed corrective action on 10. However, despite the progress made by Headquarters, DFAS, and the DFAS Denver Center, management still faced significant challenges in responding to the remaining 12 recommendations, which affected the compilation of data for the FY 1996 Air Force Consolidated Financial Statements. Included in those issues were problems related to:

- o financial accounting systems,
- o U.S. Treasury clearing accounts, and
- o the MAFR system.

Although Headquarters, DFAS, and the DFAS Denver Center had begun corrective action on all issues, the problems still existed because most of the corrective actions would not be completed before December 1999. As a result, we could not adequately evaluate the accuracy of data included in the FY 1996 Air Force Consolidated Financial Statements. Furthermore, future financial statement audits will be similarly affected as long as the problems exist.

System Improvements

Financial Management Operations. DoD has emphasized long-term efforts to improve and standardize its financial management operations, but many of the benefits of those efforts will not be realized for several years. To correct accounting system deficiencies and reduce the number of DoD accounting systems, in December 1993, DFAS established the General Funds Accounting System Improvement Plan.* Under the improvement plan, in November 1995, the DFAS Denver Center began exploring and developing the General

*For details of the plan, see IG, DoD, Report No. 96-180, "The General Fund Interim Migratory Accounting Strategy," June 26, 1996.

Ledger/Funds Control system. The overall goal of the General Ledger/Funds Control system was to integrate the production of complete, accurate, and timely financial statements and reports. Among other objectives, the General Ledger/Funds Control system was expected to:

- o produce auditable financial statements;
- o provide for a transaction-driven general ledger that complies with Federal regulations;
- o incorporate the budget and accounting classification code; and
- o bring accounting systems into conformance with generally accepted accounting principles.

In July 1996, however, the Under Secretary of Defense (Comptroller) directed DFAS to develop the Corps of Engineers Financial Management System (renamed DJAS) as the General Funds accounting migratory system for customers of the DFAS Denver Center. That decision was based on a DFAS Denver Center determination that DJAS presented a viable option to satisfy the General Funds accounting requirements of the DFAS Denver Center's customers. DFAS Denver Center management expects the DJAS to be completed in December 1999.

Audit Followup. Through its internal review function, the DFAS Denver Center monitors the status of corrective actions taken in response to prior IG, DoD, and other audit recommendations and issues periodic status reports to DFAS. DFAS uses those reports to respond to periodic followup on the status of prior audit recommendations made by the IG, DoD, under DoD Directive 7650.3, "Followup on General Accounting Office, DoD Inspector General, and Internal Audit Reports," February 14, 1992. During the followup process, the DFAS Denver Center reported to the IG, DoD, that corrective actions had not been completed on 12 prior audit recommendations made to fix problems with accounting systems and other issues. As discussed below, these problems affected our ability to evaluate the accuracy of data reported in the FY 1996 Air Force consolidated financial statements.

Financial Accounting System Issues

Previous IG, DoD, audits had identified the DFAS Denver Center's problems with automated information systems used to compile the Air Force financial statements. Those reports were IG, DoD, Report No. 94-073, "Defense Finance and Accounting Service Work on the Air Force FY 1992 Financial

Appendix C. Other Matters of Interest

Statements," March 31, 1994, and Report No. 97-057, "Compilation of FY 1995 Air Force Consolidated Financial Statements at the Defense Finance and Accounting Service Denver Center," December 27, 1996 (see Appendix B). As discussed below, correcting those problems requires major changes to DFAS financial accounting systems.

Transaction-Driven General Ledger. The DFAS Denver Center did not have a double-entry, transaction-driven general ledger system for preparing the Air Force consolidated financial statements. Without such a general ledger, the DFAS Denver Center could not prepare meaningful financial statements that met DoD accounting requirements. Recommendation A.1. in Report No. 94-073 recommended that the DFAS Denver Center develop and implement an integrated, double-entry, transaction-driven, general ledger system for preparing the Air Force financial statements. DFAS managers stated that the DJAS development includes an integrated, transaction-driven, general ledger process that will provide financial information on the General Funds for the Air Force financial statements. The DJAS is scheduled to be completed in December 1999. This issue was first reported by the GAO in FY 1990 in its audit of the FY 1988 Air Force consolidated financial statements (Appendix B), and was reported again in an FY 1992 followup report by the GAO.

Uniform Chart of Accounts. The DFAS Denver Center did not use the DoD Uniform Chart of Accounts, as required by DoD 7220.9-M, the "DoD Accounting Manual," October 1983. This chart of accounts is intended to standardize DoD accounting and meet basic reporting requirements for Federal financial statements and budgets. Instead, the DFAS Denver Center used the Air Force Chart of Accounts, which did not have the same account structure and could not be reconciled to the DoD Uniform Chart of Accounts. The DFAS Denver Center's use of the Air Force chart of accounts does not allow reconciliation of budgetary data to proprietary accounting data, which contributed to the unreliability of the data used in preparing the Air Force financial statements. Recommendation B.1. in Report No. 94-073 recommended that the DFAS Denver Center implement the DoD Uniform Chart of Accounts. According to DFAS, the DJAS should be capable of using the DoD Uniform Chart of Accounts when the system is completed in December 1999.

Military Pay Data. Military pay data reported in the Air Force consolidated financial statements were inaccurate due to year-end timing differences. The DFAS Denver Center improperly reported military separation pay in the year after it was earned. Also, the Summary of Military Pay Obligations system, used to report military pay activity, was cut off prematurely before the end of the fiscal year. Thus, payroll expenses that should have been reported in one year were improperly reported the next year. Recommendation A.6. in Report No. 94-073 recommended that the DFAS Denver Center establish procedures to adjust for year-end separation pay and other timing differences. DFAS Denver

Center managers are working to change the military pay system to provide estimates of the amounts attributable to the timing differences so that accounting personnel can manually adjust the Air Force financial statements. The DFAS Denver Center also plans to revise operating instructions to ensure that financial statements reflect the required adjustments. Those corrective actions are scheduled to be completed in FY 1998.

Use of Budgetary Data. We could not verify accounts payable reported on the Air Force Statement of Financial Position because the DFAS Denver Center used questionable budgetary data instead of general ledger data. The budgetary data may have included duplicate amounts. Recommendation B.3. in Report No. 94-073 recommended that the DFAS Denver Center use general ledger data instead of budgetary data to prepare the financial statements. DFAS expects this problem to be corrected in December 1999 with the completion of the DJAS.

Government-Furnished Material and Contractor-Acquired Material. In preparing the Air Force Consolidated Financial Statements, the DFAS Denver Center did not properly account for Government-furnished material and contractor-acquired material. The DFAS Denver Center's guidance on the reporting of those materials in the Air Force Consolidated Financial Statements was inconsistent with DoD and Air Force regulations. Recommendation D.2. in Report No. 94-073 recommended that the DFAS Denver Center develop and implement changes in internal guidance to conform to these regulations. However, the DFAS Denver Center does not have a system that can differentiate between Government-furnished material and contractor-acquired material with supporting documentation. DFAS expects this problem to be corrected with the implementation of DJAS in December 1999.

Fund Balance With Treasury. DFAS Denver Center personnel did not reconcile differences between the U.S. Treasury account balances and Air Force base-level accounts, as required by OMB and DoD regulations. OMB Circular No. A-34, "Instructions on Budget Execution," December 1995, requires that Fund Balance With Treasury on the financial statements be supported by the entity's accounting records and be reconciled to the corresponding accounts reported on the U.S. Treasury's end-of-period balances. The "DoD Accounting Manual" requires that amounts reported by the U.S. Treasury be verified against data in the agency's records. DFAS Denver Center personnel made unsupported adjustments to the "Report on Budget Execution" to force agreement with the U.S. Treasury. Recommendation B.4. in Report No. 94-073 recommended that the DFAS Denver Center reconcile the Air Force accounting records to Fund Balance With Treasury and limit adjustments to valid changes supported by documentation. DFAS Denver Center personnel now manually reconcile their balances with the U.S. Treasury every month, and all adjustments, except for undistributed amounts, are supported by

Appendix C. Other Matters of Interest

documentation. DFAS managers believe this problem will be resolved with the implementation of DJAS in December 1999.

Accuracy of Accounts Payable Data. DFAS Denver Center personnel did not include \$882.3 million of negative Accrued Expenditures Unpaid data reported by the DFAS Columbus Center and its Albuquerque, New Mexico, office (now closed). In addition, accounting personnel did not disclose in the financial statements that unreliable sources were used in determining the reported accounts payable. Recommendation A.1. in Report No. 97-057 recommended that the DFAS Denver Center coordinate with the DFAS Columbus Center to establish milestones for and monitor the progress in responding to the system change request submitted to improve the reliability of the Mechanization of Contract Administration Services system, which is used to compile and report the accrued expenditures unpaid on centrally administered contracts. The DFAS Columbus Center expects to implement the reprogrammed Accrued Expenditures Unpaid report by FY 1998.

Audit Trails. The Command On-Line Accounting and Reporting System, a major source of data for Air Force financial reports, did not provide adequate audit trails for verifying all accounting adjustments originating at the DFAS Denver Center. Audit trails were lacking because transaction history files were not available for use in verifying adjustments that accountants at the DFAS Denver Center had made to the master data files. Recommendation B. in Report No. 97-057 recommended the use of transaction history files to establish a complete and accurate audit trail of all adjustments made by accounting personnel at the DFAS Denver Center to data reported through the computer system. Because the Command On-Line Accounting and Reporting System is a legacy system, funding for corrections has not been budgeted. The DFAS managers believe this problem will be resolved with the implementation of DJAS in December 1999.

U.S. Treasury Clearing Account Issues

IG, DoD, Report No. 95-067, "Defense Finance and Accounting Service Work on the Air Force FY 1993 Financial Statements," December 30, 1994, identified two problems with the monitoring of U.S. Treasury clearing accounts. As detailed below, the DFAS Denver Center planned both short- and long-term corrective actions.

Reconciliation of Clearing Accounts. In preparing the Air Force consolidated financial statements, the DFAS Denver Center did not adequately monitor U.S. Treasury clearing accounts by reconciling the differences between those account balances and Air Force base-level accounts. Also, the DFAS Denver

Center did not reconcile one clearing account to the U.S. Treasury balance. Finally, the DFAS Denver Center did not reconcile its own records with those maintained at base level and by the U.S. Treasury. Recommendation A.1. in Report No. 95-067 recommended that the DFAS Denver Center semiannually reconcile Department of the Air Force-level clearing account balances, base-level certified balances, and U.S. Treasury balances. In response, the DFAS Denver Center manually reconciled those accounts.

Old Clearing Account Balances. In preparing the Air Force financial statements, the DFAS Denver Center personnel did not take sufficient action to resolve old clearing account balances at the Defense accounting offices. For example, 60 percent of the balance in one clearing account represented transactions that were 6 to 11 months old, while another 20 percent of the account balance represented transactions more than 1 year old. Recommendation A.4. in Report No. 95-067 recommended that the DFAS Denver Center notify the Defense Accounting Offices when clearing account balances are more than 60 days old and require their resolution. To correct this situation, the DFAS Denver Center requested a change to the "DoD Financial Management Regulation" requiring the Defense Accounting Offices to resolve clearing account items within 1 year. The DFAS Denver Center expects this change to be made by April 1998.

MAFR System Issues

Problems related to the MAFR system's internal controls over reconciling account balances and maintaining an adequate audit trail were identified in IG, DoD, Reports No. 94-073 and No. 95-264, "Defense Finance and Accounting Service Work on the Air Force FY 1994 Financial Statements," June 29, 1995. As detailed below, the DFAS Denver Center planned to correct those problems by April 1998.

MAFR System Reconciliations. In preparing the FY 1992 Air Force consolidated financial statements, the DFAS Denver Center did not reconcile out-of-balance cash disbursements and receipts in the MAFR system. The MAFR system accounts for all cash transactions affecting the Air Force and provides consolidated cash accountability and reporting. Air Force Regulation 177-101, "General Finance and Accounting Systems at Base Level," February 15, 1991, requires the DFAS Denver Center to reconcile the cumulative dollar amounts at the department level to the monthly MAFR packages submitted by each Air Force disbursing station. If an out-of-balance condition exists, DFAS Denver Center personnel are to establish the source of the condition, require a reconciliation of data, and correct the out-of-balance condition. Recommendation A.4. in Report No. 94-073 recommended that the

Appendix C. Other Matters of Interest

DFAS Denver Center perform MAFR system reconciliations and make appropriate corrections. To correct this situation, the DFAS Denver Center enhanced the manual internal controls in the MAFR system and requested a system change to automate those reconciliations. The change was expected to be completed by April 1998.

MAFR Audit Trails. The MAFR system, although used in preparing the FY 1994 Air Force financial statements, did not maintain an adequate audit trail or transaction histories for transactions originating at the DFAS Denver Center. As a result, DFAS Denver Center managers could not identify all the adjustments to the MAFR system database and, therefore, could not verify that such adjustments were adequately supported or properly recorded. Before the prior audit was completed in February 1995, the DFAS Denver Center included the requirement for audit trails in the specifications for the Defense Cash Management System, which was expected to replace the MAFR system in January 1998. Therefore, Report No. 95-264 made no recommendations on this matter.

Summary

Correcting prior audit issues is crucial to providing the means for adequately evaluating the Air Force consolidated financial statements prepared by the DFAS Denver Center. However, because the DFAS Denver Center had initiated and was monitoring the status of corrective actions, we are making no further recommendations.

Appendix D. Report Distribution

Office of the Secretary of Defense

Under Secretary of Defense (Comptroller)
Deputy Chief Financial Officer
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Deputy Comptroller (Program/Budget)
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Assistant Secretary of the Navy (Financial Management and Comptroller)
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Department of the Air Force

Assistant Secretary of the Air Force (Financial Management and Comptroller)
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Appendix D. Report Distribution

Other Defense Organizations

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Director, Defense Finance and Accounting Service
 Director, Defense Finance and Accounting Service Denver Center
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House Committee on Appropriations
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House Subcommittee on Government Management, Information, and Technology,
 Committee on Government Reform and Oversight
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 Committee on Government Reform and Oversight
House Committee on National Security

Part III - Management Comments

Defense Finance and Accounting Service Comments



DFAS-HQ/AFB

DEFENSE FINANCE AND ACCOUNTING SERVICE

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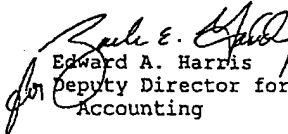
NOV 19 1997

MEMORANDUM FOR DIRECTOR, FINANCE AND ACCOUNTING DIRECTORATE,
OFFICE OF THE INSPECTOR GENERAL, DEPARTMENT
OF DEFENSE

SUBJECT: Audit Report on Compilation of FY 1996 Air Force
Consolidated Financial Statements at the Defense
Finance and Accounting Service Denver Center (Project
No. 6FD-2026)

We have reviewed the subject report and our comments are
attached.

Please direct any questions concerning this matter to
Mr. Charles McIntosh on (703) 607-5105.


Edward A. Harris
Deputy Director for
Accounting

Attachment:
As stated

Defense Finance and Accounting Service Comments

SUBJECT: Audit Report on Compilation of FY 1996 Air Force Consolidated Financial Statements at the Defense Finance and Accounting Service Denver Center (Project No. 6FD-2026)

General Comments. The DFAS has undertaken an effort to respond to regulatory financial management compliance requirements by developing requirements for a standard interim departmental accounting system, the Defense Departmental Reporting System (DDRS). The DDRS will address streamlining the departmental fiduciary reporting process and standardizing the departmental report process to include the Chief Financial Officers Act report requirements. The existing rules and tables used in the CFO Reporting System will be perpetuated in the DDRS to accommodate DFAS-DE requirements and business practices. When available, DFAS-DE will begin using DDRS for preparation of departmental reports, including CFO statements, and the CFO Reporting System will be replaced. The implementation of DDRS will not address the material weaknesses that result from the absence of a transaction-driven general ledger system at base-level. However, it will eliminate the findings against the CFO Reporting System that pertain to lack of systems documentation, security, and maintainability. The DDRS should be available for DFAS-DE usage no later than October 1, 1998.

Page 3, second paragraph. The paragraph is not complete. The Air Force General Funds General Ledger is summarized by Air Force base and general ledger account code. However, in addition to the above, for CFO reporting purposes, the data are subsequently summarized by both operating account code and at the Air Force level.

Recommendation 1. We recommend that the Director, Directorate of Departmental Accounting, Defense Finance and Accounting Service Denver Center:

a. Direct the Chief, Chief Financial Officers Branch, Directorate of Departmental Accounting, to:

(1) Document the procedures used to manually reconcile the data imported into the Chief Financial Officers Reporting System from the DD Form 1176, "Report on Budget Execution," produced by the Status of Funds system.

(2) Periodically monitor access controls over the Chief Financial Officers Reporting System and provide annual written reports on compliance with Recommendations 1.b.(1) and (2) below.

Defense Finance and Accounting Service Comments

Management comments on Recommendation 1.a.(1). Concur. The automated and manual reconciliation process that ensures that imported data agree with budgetary reports has been documented in a Branch Operating Instruction. Corrective actions were completed in June 1997.

Management comments on Recommendation 1.a.(2). Concur. The designated system administrator reviews and controls access to the CFO Reporting System. The system administrator disables system access when an associate's responsibilities no longer require system access. However, the associate's USERID cannot be deleted if the USERID is tied to a previous journal voucher. The system administrator has been tasked to review access to the CFO Reporting System on an annual basis and to provide feedback to management, including usage of access and screen saver passwords. Estimated completion date is June 1998.

b. Direct all authorized users of the Chief Financial Officers Reporting System to establish:

(1) Passwords of at least six alphanumeric characters for obtaining access to the Chief Financial Officers Reporting System.

(2) Screen saver password controls in Microsoft Windows.

Management comments on Recommendation 1.b.1 and 1.b.2. Concur. All users of the CFO Reporting System have screen savers with password controls that prompt the users after 5 minutes. All users of the CFO Reporting System are required to establish passwords that are at least 6 alphanumeric characters. Corrective actions were completed in December 1996.

Recommendation 2. We recommend that the Director, Defense Finance and Accounting Service Denver Center, review and approve future plans for maintaining the Chief Financial Officers Reporting system.

Management comments on recommendation 2. Concur. Procedures have been established for the Director, Defense Finance and Accounting Service Denver Center, to review and approve future plans for maintaining the Chief Financial Officers Reporting System. Corrective actions completed in October 1997.

Audit Team Members

This report was prepared by the Finance and Accounting Directorate, Office of the Assistant Inspector General for Auditing, DoD

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INTERNET DOCUMENT INFORMATION FORM

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